



STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

Date Amended:	04/22/03	Bill No:	SB 1009
Tax:	Sales and Use	Author:	Alpert
Board Position:		Related Bills:	AB 1741 (AR&T)

BILL SUMMARY

This bill would, for purchases made on or after January 1, 2004, and through December 31, 2009, authorize an individual to report qualified use tax on their California personal income tax return.

Summary of Amendments

Previous version of this bill contained provisions related to state employee compensation. These provisions were removed from the bill and replaced with the provisions authorizing an individual to report qualified use tax on their California personal income tax return.

ANALYSIS

Current Law

Under existing law, Chapter 3 (commencing with Section 6201) of Part 1 of Division 2 of the Revenue and Taxation Code, a use tax is imposed on the storage, use, or other consumption in this state of tangible personal property purchased from any retailer. The use tax is imposed on the purchaser, and unless that purchaser pays the use tax to a retailer registered to collect the California use tax, the purchaser is liable for the tax, unless the use of that property is specifically exempted or excluded from tax. The use tax is the same rate as the sales tax and is required to be remitted to the Board of Equalization (Board) on or before the last day of the month following the quarterly period in which the purchase was made.

Under the law, in cases where a purchaser fails to file a return and report their use tax obligations, the Board may assess past due tax obligations for a period as far back as eight years.

The Board is the state agency responsible for administering the provisions of the use tax. The Franchise Tax Board (FTB) is responsible for administering the personal income tax and the corporate franchise tax. For many years, the FTB has included in the personal income tax booklet instructions for paying California use tax. In an effort to make reporting use tax more convenient for the public, and to further educate California residents of their possible use tax reporting requirements, the Board made arrangements with the FTB to insert a California Individual Use Tax Return into the center of the 2002 personal income tax booklets that were mailed to taxpayers and made available in public areas.

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Proposed Law

This bill would add and repeal Sections 6452.1 and 6487.3 of the Sales and Use Tax Law which would provide that every individual that purchases tangible personal property which is subject to the qualified use tax may elect to report qualified use tax on his or her California personal income tax return.

This bill would define the term "individual" to mean any natural person.

This bill would define the term "qualified use tax" to mean the use tax imposed on the storage, use, or other consumption of tangible personal property, used exclusively for personal purposes within this state, that is brought into this state by an individual or that is shipped to an individual within this state by a retailer located outside of this state. "Qualified use tax" would not include any of the following:

- Use tax that applies to a mobilehome or a commercial coach that is required to be registered annually pursuant to the Health and Safety Code or use tax that applies to a vehicle subject to identification under Division 16.5 (commencing with Section 38000) of the Vehicle Code.
- Use tax imposed on a vessel or aircraft.
- Use tax imposed on a lessee of tangible personal property.
- Use tax imposed on an individual if that individual's use tax liability for the calendar year is four hundred dollars or less.

This bill would provide that in the case of a married individual filing a separate California personal income tax return, an election may be made to report either one-half of the qualified use tax or the entire qualified use tax on his or her separate California personal income tax return. If an individual elects to report one-half of the qualified use tax, that election will not be binding with respect to the remaining one-half of the qualified use tax owed by that individual and that individual's spouse.

This bill would require that if an individual elects to report qualified use tax on his or her California personal income tax return, that individual shall comply with all of the following:

- The qualified use tax shall be reported on and remitted with his or her timely filed California personal income tax return.
- The qualified use tax shall be reported on and remitted with the California personal income tax return that is required to be filed for the taxable year in which the liability for the qualified use tax was incurred.

This bill would provide the following provisions for the purpose of administering the qualified use tax:

- Responsibility for the collection and receipt of the qualified use tax would be transferred from the Board to the FTB.
- Penalties and interest would apply in accordance with the personal income tax laws in lieu of the sales and use tax laws.

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- Any claims for refund for qualified use tax shall be made in accordance with existing sales and use tax laws regarding overpayments and refunds.
- The Board would not be precluded from making any determinations for understatements of qualified use tax in accordance with existing sales and use tax laws.
- The statute of limitations with respect to qualified use tax reported shall be three years after the last day for which the California personal income tax return is due or filed, whichever occurs later.
- In the event of gross understatement of qualified use tax, the statute of limitations shall be six years after the last day for which the California personal income tax return is due or filed, whichever occurs later.
- The FTB would be required to remit the qualified use tax and any applicable interest and penalties collected pursuant to the provisions in this bill to the Board within 60 days from the date the qualified use tax is received by the FTB. The FTB may deduct from any amounts to be paid to the Board amounts necessary to cover the cost of administration of these provisions by the FTB.
- If an individual elects to report qualified use tax on his or her California personal income tax return, but the payment is insufficient to satisfy the combined liability for personal income tax and qualified use tax, the amount remitted shall be applied in the following order:
 1. Personal income tax
 2. Penalties and interest, if any, on the personal income tax
 3. Qualified use tax

The provisions in this bill would apply to purchases of tangible personal property made on or after January 1, 2004, and on or before December 31, 2009.

Background

The collection of use tax relies heavily on the voluntary compliance of purchasers of tangible personal property. However, due to the general misconception that purchases from outside this state are "tax free" and the insufficient audit resources to go after all purchasers, the voluntary compliance rate has been very low. Ex-tax purchases from out of state retailers is regularly the largest area of non-compliance the Board's audit staff encounters. That is why the Board has sought other avenues to attempt to increase use tax compliance, including publishing instructions for reporting use tax in the personal income tax booklet distributed by the FTB.

Currently a joint effort between the Board and the FTB to include a line on the personal income tax return asking if the taxpayer has made any purchases from outside this state without payment of tax is being considered. Unlike the provisions in this bill, this proposal would not require reporting of the tax on the personal income tax return, but would instead instruct the taxpayer to complete the individual use tax return and mail payment to the Board.

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Several other states have taken the step of including a use tax line on the state income tax return. The most recent examples are Ohio and Michigan. Ohio first had a use tax line in 2000. Use tax receipts prior to adding the use tax line were minimal. Use tax receipts after addition of the use tax line were approximately \$1.7 million, with slightly less than 1 percent of all taxpayers reporting use tax. Michigan added a use tax line in 1999. Use tax receipts prior to adding the use tax line were approximately \$240,000 per year. Use tax receipts after the addition of the use tax line were approximately \$2.9 million, with about 1.5 percent of all taxpayers reporting the use tax.

COMMENTS

1. **Sponsor and Purpose.** This bill is sponsored by the author in an effort to increase use tax compliance.
2. **Summary of amendments.** April 22 amendments removed provisions related to state employee compensation and inserted provisions authorizing an individual to report qualified use tax on their California personal income tax return.
3. **Purchase dates.** The provisions in this bill would apply to purchases of tangible personal property made on or after January 1, 2004. Personal income tax returns for this period would most likely not be filed until after January 1, 2005.
4. **Definition of Individual.** This bill would allow any individual to elect to pay qualified use tax on his or her personal income tax return. This bill defines the term "individual" as any natural person. The provisions of this bill would exclude partnerships and corporations. The Board has estimated that of the uncollected use tax, approximately two-thirds of the uncollected revenue is from business to business sales. Therefore, excluding partnerships and corporations from the provisions in this bill could exclude a large portion of the uncollected revenue. It is recommended that the definition of individual be expanded to include partnerships and corporations.
5. **Exclude permit holders.** This bill would allow an individual to elect to report qualified use tax on his or her personal income tax return in lieu of reporting use tax directly to the Board. Many individuals currently hold a seller's permit with the Board and already report a use tax liability. It is recommended that the bill be amended to exclude permit holder's from the definition of an individual.
6. **Qualified use tax.** The provisions in this bill would only apply to qualified use tax. As defined in this bill, qualified use tax would only include use tax in excess \$400 per calendar year. Based on the current tax rates, \$400 in qualified use tax could consist of purchases costing between \$4,700 and \$5,500, depending on the purchasers location.
7. **Tax allocation.** This bill would require the FTB to remit the qualified use tax received to the Board within 60 days from the date the tax is received. In order to properly administer the local tax and district tax laws, the Board would need to obtain certain information from the FTB. At a minimum, the Board would need to know the name and address for each taxpayer so the Board may properly allocate local and district taxes.

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- 8. Gross understatement of qualified use tax.** This bill would provide that if an individual reports an amount that is deemed to be a gross understatement of qualified use tax on his or her personal income tax return, the statute of limitations would be extended from three years to six years. This bill would define the term "gross understatement of qualified use tax" to mean a deficiency that is in excess of 25 percent of the amount of qualified use tax reported on the personal income tax return.
- 9. Get the word out.** Collecting qualified use tax would rely to a great extent on voluntary compliance. For the provisions of this bill to be successful, the public must be made aware of the qualified use tax. Working with the tax professional community and the tax preparation software industry could result in more individuals being made aware of use tax liabilities.
- 10. Suggested technical amendments.** This bill would allow individuals to make payments for qualified use tax to the FTB rather than the Board, it is recommended that Section 7101 of the Revenue and Taxation Code be amended to read:

"All fees, taxes, interest, and penalties, imposed and all amounts of tax required to be paid to the State under this part, except as provided in Section 6452.1, shall be paid to the board in the form of remittances payable to the State Board of Equalization of the State of California. The board shall transmit the payments to the State Treasurer to be deposited in the State Treasury to the credit of the Retail Sales Tax Fund."

The definition of qualified use tax excludes use tax that applies to a mobilehome, commercial coach, off-highway vehicle, vessel, or aircraft. Due to changes in the Vehicle Code, it is recommended that page 3, line 30 of this bill be amended to read:

"38000) of the Vehicle Code- or a vehicle that qualifies under the permanent trailer identification plate program pursuant to subdivision (a) of Section 5014.1 of the Vehicle Code."

As written, the definition of qualified use tax would not exclude vehicles. It is recommended that page 3, line 31 of this bill be amended to read:

"(ii) Use tax imposed on a vehicle, vessel or aircraft."

Additional suggested amendments due to apparent drafting errors would include:

Page 3, line 28, to read "and Safety Code or use tax that applies to a vehicle subject to"

Page 7, line 3, to read "18150. (a) The Franchise Tax Board shall, revise the"

- 11. Related legislation.** Assembly Bill 1741 (Assembly Revenue and Taxation Committee) would limit the period in which the Board may assess unpaid use taxes for qualified California purchasers that voluntarily self-report their use tax obligations to 3 years. This Board-sponsored bill is an effort to encourage voluntary compliance with the use tax laws by reducing the existing period within which the Board may issue a notice of determination against taxpayers from eight years to three. The purpose of this measure is to encourage individuals as well as businesses who currently do not hold seller's permits (e.g., food processors or service industry

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businesses) to report their use tax with the incentive of a three-year statute of limitations.

COST ESTIMATE

Some costs would be incurred in programming, notifying taxpayers, answering inquiries, writing appropriate regulations, revising and processing returns. An estimate of these costs is pending.

REVENUE ESTIMATE

Background, Methodology, and Assumptions

Personal Income Taxpayers. Last year we estimated that the total use tax revenue loss related to remote sales (mail order and electronic commerce sales) from out-of-state vendors to California households was \$456 million, \$309 million in mail order sales and \$147 in electronic commerce sales. (These revenue estimates assume a total statewide average tax rate of 7.92 percent, and are documented in a revenue estimate, "Electronic Commerce and Mail Order Sales," April 12, 2002.) These figures are based on U.S. Census Bureau data through 2001. The 2002 data from the U.S. Bureau of Census data would indicate little change in the \$456 million figure. The more recent Census data show that in 2002 U.S. Internet sales increased but mail order sales declined, resulting in little change in the total U.S. remote sales figure.

Results from a 2002 Federation of Tax Administrators (FTA) survey show that 13 states have a line that enables taxpayers to declare use tax liabilities on their state personal income tax forms. Of these 13 states, 10 states provided data on numbers of returns filed and total use tax liabilities. No data were provided for total numbers of personal income tax filers for these states. The use tax rates vary from 4.2 to 6.0 percent for the states for which we have data.

We obtained population figures from the U.S. Census Bureau for the 10 states for which we had data. Then we calculated the number of returns divided by population to determine a participation rate. The average participation rate (weighted by population) for these 10 states was 0.6 percent. U.S. adult population is about 74 percent of total population. (California adult population is a similar percentage, about 73 percent of total population.) An adult participation rate for the 10 states could be approximated by dividing the participation rate of 0.6 percent by the adult population percentage of 74 percent. This calculation yields an adult participation rate of approximately 0.8 percent ($0.6 / 0.74 = 0.8$). Based on these facts, it would seem reasonable to assume that approximately one percent of unpaid use tax liabilities (a rounding off of the 0.8 percent figure) would be reported by having a line on the personal income tax form. One percent of \$456 million is approximately \$5 million.

Business Income Taxpayers. In 2002, we estimated the electronic commerce use tax revenue loss to be \$783 million from out-of-state businesses to California businesses. (These revenue estimates are documented in a revenue estimate, "Electronic Commerce and Mail Order Sales," April 12, 2002.) As was the case with consumers,

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more recent data released since this estimate was made would indicate little change in this figure.

Most of the business-to-business remote sales tax impacts are associated with tax payments due from California businesses that legally are not required to register with the Board because they do not sell tangible personal property. Gross State Product (GSP) industry statistics show that over 50 percent of 1999 GSP was from service industries or finance, insurance, and real estate industries, most of which are not required to register with the Board.

Unlike personal income taxes, we are not aware of any states that allow businesses to report use tax liabilities on their corporate or other business income tax forms. About 90 percent of California businesses have fewer than 20 employees and could be considered to be relatively small. It would seem reasonable to expect use tax compliance rates for small businesses to be similar to those of individuals.

Since we have no specific information for businesses, we will also assume that having a line on corporate, subchapter S, and partnership income tax forms would result in one percent of unpaid use tax liabilities being reported. One percent of \$783 million is approximately \$8 million.

Revenue Summary

As this bill is currently written, we would expect sales and uses taxes reported to be \$5 million per year. If the bill is later amended to include lines on business income tax forms, an additional \$8 million would be reported, for a total of \$13 million. The average state, local, and transit district revenue impacts associated with this bill, if amended, are estimated to be

State Impact (5.0%)	\$ 8.2 million
Local Impact (2.25%)	\$ 3.7 million
<u>Transit Impact (0.67%)</u>	<u>\$ 1.1 million</u>
 Total	 <u>\$ 13.0 million</u>

Qualifying Remarks

These revenue estimates assume compliance is largely voluntary. Costs of ensuring greater compliance could be high since there are a large number of potential taxpayers.

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